Supreme Court, U.S.
FILED
MAR 15 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1160

In the Supreme Court of the United States

OCTOBER TERM, 1988

C.F. CORNELIUS, PERSONAL REPRESENTATIVE, ESTATE OF JOHN MCDONALD, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether an attempted election of special use valuation of farm property under Section 2032A of the Internal Revenue Code (26 U.S.C.) is eligible to be perfected belatedly if the election was invalid because the materials submitted with the initial estate tax return failed to identify all three heirs with present interests in the property and to furnish their consent to the election.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A3-A18) is reported at 853 F.2d 1494. The opinion of the Tax Court (Pet. App. A19-A42) is reported at 89 T.C. 293.

JURISDICTION

The judgment of the court of appeals was entered on August 17, 1988. A petition for rehearing was denied on September 15, 1988 (Pet. App. A43). The petition for a writ of certiorari was filed on December 12, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. John McDonald (decedent), a resident of North Dakota, died testate on January 16, 1981. He was survived by his widow, Gladys, four children, and three grandchildren. Except for some small specific bequests, the will provided that Gladys was to inherit all of decedent's property, if she survived him. On September 23, 1981, Gladys disclaimed her interest in the farmland she stood to inherit under the terms of decedent's will. As a result of this disclaimer, the property passed to three of decedent's children, Virlyn McDonald, Dorothy Spicer and Gladys Jean Cox, in equal shares. Pet. App. A5.

The federal estate tax return for decedent's estate was timely filed with the Internal Revenue Service on October 7, 1981. The farmland was "qualified real property" under Section 2032A(b) of the Internal Revenue Code,[1] and therefore eligible for special use valuation if the estate so elected.[2] Included in this return was a "Notice of Election

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

[2] Section 2032A of the Code provides a limited exception to the general rule that property is valued for estate tax purposes at its fair market value on the date of the decedent's death. If the estate elects Section 2032A treatment and certain conditions are met, which indicate that the property will continue to be used by the family for a "qualified use" (*i.e.*, as a family farm or business (I.R.C. § 2032A(b)(2)) for a specified number of years, the estate is permitted to value qualified real estate at its value for the qualified use, rather than its fair market value. The purpose of Section 2032A is to grant relief to the heirs of family farms who might otherwise find that valuation of inherited farmland at its highest and best use, such as for real estate development, would produce such a large estate tax liability that it would be necessary to liquidate the land in order to pay the tax. See H.R. Rep. No. 1380, 94th Cong., 2d Sess. 21-22 (1976). If, however, the property ceases to be used by the family for a qualified use during

of Special Use Valuation As Authorized by Section 2032A" and an "Agreement Relating to Special Use Valuation Under Section 2032A Of The 1976 Tax Reform Act." Both documents were signed by Gladys McDonald and by C.F. Cornelius, the personal representative of the estate, and they listed Gladys as the only person with an interest in the farmland on which special use valuation was elected. Pet. App. A5-A6.

On February 26, 1982, an amended federal estate tax return was filed. The amended return contained an amended "Agreement Relating To Special Use Valuation Under Section 2032A Of The 1976 Tax Reform Act," signed by Virlyn McDonald, Dorothy Spicer, Gladys Jean Cox, and three of decedent's grandchildren. On audit, the Commissioner determined that the estate did not qualify for the benefits of Section 2032A because the election documents filed with the initial estate tax return were not in substantial compliance with the requirements set forth in the applicable Treasury Regulations, and therefore the election could not be perfected belatedly by the amended agreement. Pet. App. A5-A6.

2. Petitioner sought redetermination of the asserted deficiency in the Tax Court, which, in a reviewed opinion, unanimously held that the estate did not qualify for special use valuation of farm property under Section 2032A (Pet. App. A30-A39).[3] The court found that the initial election

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the specified period, the IRS is entitled to "recapture" the estate tax that had been saved by means of the special use election. See I.R.C. § 2032A(c)(1)(B).

[3] In a separate gift tax deficiency notice addressed to Gladys, the Commissioner took the position that her disclaimer of her interest in certain property that she had held as a joint tenant with decedent was untimely under Section 25.2511-1(c) of the Gift Tax Regulations (26 C.F.R.). Her petition for redetermination of the resulting deficiency

was invalid (*id.* at A33-A35) because it did not contain the signature of the heirs, which is an "essential element of the special use valuation provision" (*id.* at A34). The court then noted that, under Section 2032A(d)(3), a defective election can be perfected later only where the election documents initially filed were in substantial compliance with the requirements of the Treasury Regulations (Pet. App. A36-A37). The court further found that the special provision for curing a defective election under Section 1421 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2717, is limited to cases in which the initial filings provide substantially all the information required by the estate tax return, and that the provision had been enacted specifically to alleviate unfairness caused by incomplete instructions in one version of the estate tax return (Form 706) (Pet. App. A37-A38). Since the materials filed with the estate tax return in this case failed to identify three of the qualified heirs or to secure their consent to the election, the court determined that "the Estate's factual situation falls far outside of either amendment's ambit" (*id.* at A38). It concluded that the initial election attempt was not in substantial compliance with the requirements set forth in the Treasury Regulations or on the estate tax return and therefore could not be perfected later (*id.* at A38-A39).

3. The court of appeals affirmed (Pet. App. A6-A13). Since the disclaimed property was treated under North Dakota law as having passed directly to the three children as if Gladys had predeceased the decedent, the court rejected petitioner's threshold argument that her consent alone satisfied the regulatory requirements (*id.* at A8). The

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was consolidated with this case below. The Tax Court upheld the gift tax deficiency (Pet. App. A22-A30), but the Eighth Circuit reversed (*id.* at A13-A18). No issue pertaining to that gift tax deficiency is presented here.

court of appeals also rejected petitioner's contention that the estate was eligible to perfect its election under Section 2032A(d)(3) of the Code. The court noted that "[t]he statutory language, as a precondition to the addition of signatures, requires that the original election substantially comply with 26 C.F.R. Section 20.2032A-8, which includes the requirement that the original agreement be binding on all parties taking an interest in the property" (Pet. App. A10). "Based only on this language," the court continued, "it is difficult to conclude that the original election was in substantial compliance with this requirement when it contained neither the name nor the signature of anyone with an interest in the property as of the date of Decedent's death" (*ibid.*). The court noted that its conclusion was supported by the pertinent legislative history, which states in part that " '[t]o be eligible for perfection, the agreement as originally filed must at a minimum be valid under State law and must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value' " (*id.* at A11, quoting H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. at 1241 (1984)). The court, relying on illustrations from the legislative history, concluded that Congress intended to permit perfection of an election only where the original election contained "slight technical failures" (*id.* at A12 & n.6). It held that "the omission from the recapture agreement of the signatures of all persons with an interest in the property is not the type of slight technicality envisioned by Congress * * *" (*id.* at A11-A12).

The court of appeals also rejected petitioner's argument that he was entitled to perfect the election under Section 1421 of the Tax Reform Act of 1986 (Pet. App. A13). Because petitioner did not contend that the return he used suggested different requirements from those specified in

the Treasury Regulations, the court concluded that the estate did not qualify for relief under this provision (*ibid.*).

ARGUMENT

The court of appeals correctly rejected petitioner's attempt to cure the estate's faulty election of special use valuation. The decision of the court of appeals does not conflict with any decision of this Court or of another court of appeals. Accordingly, review by this Court is not warranted.

1. Section 2032A confers a substantial tax benefit in permitting an estate to elect to value qualifying real estate for estate tax purposes based on its actual use, rather than its highest and best use. Congress established several conditions that must be satisfied in order to qualify for this favorable treatment. Of relevance here, Section 2032A and Treas. Reg. § 20.2032A-8(a)(3) (26 C.F.R.), specify the procedures that must be followed to make a valid election. They require the executor to file, as part of a timely estate tax return, a notice of election identifying, *inter alia*, all persons with interests in the specially valued property and an agreement expressing the consent of the heirs to be liable for the recapture of the special tax benefits in the event of a premature disposition of the property or cessation of its qualified use within a specified period.[4]

Secton 2032A(d)(3) permits a defective election to be perfected later, but by its terms it makes that opportunity available only where the initial election, although defective in minor respects, is already in "substantial compliance" with the requirements of the Treasury Regulations. The

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[4] This agreement, commonly known as a "recapture agreement," ensures that the IRS will be able to collect the tax that had been avoided through election of the special use valuation. See Section 2032A(c)(1)(B); *Martin* v. *Commissioner*, 783 F.2d 81 (7th Cir. 1986).

pertinent legislative history states that "[b]oth a notice of election and an agreement that themselves evidence substantial compliance with the requirements of the regulations must be included with the estate tax return, as filed, if the estate is to be permitted to perfect its election." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1240-1241 (1984). To be valid under the regulations, a recapture agreement must be in a form that is binding under local law and must be executed by all parties with interests in the property as of the decedent's death. The heirs must expressly consent to personal liability for the recapture of the special benefits in the event of a premature disposition of the property or cessation of its qualified use. See Treas. Reg. § 20.2032A-8(c). These requirements implement the congressional intent reflected in the legislative history of the substantial compliance provision (H.R. Conf. Rep. No. 861, *supra,* at 1241): "To be eligible for perfection, the agreement as originally filed must at a minimum be valid under State law and must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value."

2. Under this statutory framework, it is clear that the courts below correctly determined that the estate was not eligible to perfect its election. By the time the estate filed its tax return, Gladys had disclaimed her interest in the farmland she stood to inherit under the will, and the property therefore passed to three of decedent's children. Accordingly, those children had a continuing interest in the land, giving them the authority to determine if the land would continue to be used for a qualified use, and they were liable for recapture of the estate tax savings if they took steps inconsistent with the special use valuation—such as transferring ownership of the property or putting it to a nonqualifying use within the period specified by Section 2032A. Moreover, under North Dakota

law, Gladys's renunciation of decedent's property related back to the date of his death, and the disclaimed property passed to the three children as if Gladys had predeceased the decedent. Thus, it was apparent at the time the estate tax return was filed that the children were persons having "an interest * * * in [the] property" (I.R.C. § 2032A(d)(2); see also Treas. Reg. § 20.2032A-8(c)(1)) who were required to take part in the election.

Petitioner, however, filed with the estate tax return a notice of election and recapture agreement identifying Gladys, who no longer had an interest in the subject property, as the sole heir; the three children were not identified as persons having an interest in the property to be specially valued, and they did not consent to the imposition of the recapture tax. This election was far from "substantially compl[ying]" (I.R.C. § 2032A(d)(3)(B)) with the provisions of the Treasury Regulations, which require the attachment of a recapture agreement signed by all persons with interests in the property and binding under local law. Rather, the omission of the three persons who stood to inherit the property went to the heart of the election's validity, and therefore the terms of the statute do not permit the estate's initial election to be perfected belatedly. There are compelling reasons for this insistence by Congress that the documents as initially filed meet the "substantial compliance" standard. As explained by the Staff of the Joint Committee on Taxation, "[u]nless some level of compliance with Treasury regulations were required, some persons might intentionally neglect to comply unless they were discovered on examination." Staff of Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* 1123 (Joint Comm. Print 1984). The result reached here by the courts below also accords with the principle recognized in other contexts that, where a statute demands specific, contem-

poraneous, and incontrovertible evidence of a binding decision to accept the tax consequences imposed by an election, the failure to supply unequivocal proof of the required consent to the election goes to the essence of the election, precluding its subsequent perfection. See, *e.g.*, *Dunavant* v. *Commissioner,* 63 T.C. 316 (1974); *Valdes* v. *Commissioner,* 60 T.C. 910 (1973).

There is no merit to petitioner's contention (Pet. 8-9) that this Court should grant certiorari to rectify what he terms the "mis-use" (Pet. 8) of legislative history. First, as the court of appeals noted (Pet. App. A10), application of the statutory language alone, without resort to the legislative history, indicates that the estate cannot belatedly perfect an election that does not contain the names or signatures of any of the three people who stood to inherit the property. In any event, the court of appeals correctly concluded (*id.* at A11) that it is appropriate to look to the legislative history for guidance in interpreting the statutory term "substantial compliance." Petitioner advances no basis for his suggestion (Pet. 9) that the legislative history of Section 2032A(d) is inconsistent with the intent of Congress, and therefore the court of appeals correctly relied on the legislative history as a guide to interpreting the statute.

3. The court of appeals also correctly rejected petitioner's contention that the defective election could be perfected under Section 1421 of the Tax Reform Act of 1986, *supra.* By its terms, that statute limits relief to those instances where the executor has "provided substantially all the information with respect to such election required on such return of tax." The legislative history discloses that Congress added this provision because it was concerned that faulty instructions on one version of the estate tax return (Form 706) had induced taxpayers to fail to comply with the regulatory requirements for making the

election. Accordingly, the statute permits the late filing of recapture agreements by estates that had used a faulty version of Form 706, which did not specify that the agreement had to be submitted with the estate tax return, so long as the estate had substantially complied with the instructions stated on the return. S. Rep. No. 313, 99th Cong., 2d Sess. 876 (1986); H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. pt. 2, at 770-771 (1986).

This provision has no application here. The January 1979 version of Form 706 used here in fact specified that the heirs' consent to the recapture tax must be submitted with the return, and petitioner does not contend that the estate's failure to comply with the regulatory requirements had anything to do with any error in the instructions on the return. On the contrary, in failing to have the three persons with an interest in the property agree to the election, the estate did not "provide[ ] substantially all the information with respect to such election required on such return of tax," as required by Section 1421, and the 1986 Act provides no basis for a belated perfection of the election.[5]

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[5] Although there is no conflict in the circuits, petitioner suggests that certiorari is appropriate here because there are two other cases involving this issue that were appealed from district court decisions in favor of the estate. One of those cases has now been decided on appeal, with the court of appeals reversing and ruling in favor of the government in reliance on the decision below. *Foss* v. *United States,* No. 88-5152 (8th Cir. Jan. 9, 1989). The other case is still pending, *Prussner* v. *United States,* 87-2 U.S.T.C. (CCH) ¶ 13,739 (C.D. Ill. Oct. 13, 1987), appeal pending, No. 88-1933 (7th Cir.), but it is, in any event, distinguishable from the instant case. In *Prussner,* no recapture agreement was submitted with the return, but the estate's attorney explicitly alerted the IRS to that fact, explaining that he was having difficulty obtaining the signatures of heirs residing throughout the country. While we have argued in *Prussner* that the estate did not "substantially comply" with the regulatory requirements since no consent or recapture agreement was filed with the return, at least the IRS

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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MARCH 1989

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was at all times on notice that the election was defective and that steps were being taken to perfect it. Here, by contrast, the IRS could discover only by examination that the election documents had been filed by the wrong person, and therefore that it did not have a recapture agreement from the persons actually liable for any recapture tax.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1989—241-699/00156